

Updated Informative Digest for
Adoption of California Code of Regulations,
Title 18, Section 1685.5,
Calculation of Estimated Use Tax - Use Tax Table

Out-of-state retailers that are “engaged in business in this state,” as defined by Revenue and Taxation Code (RTC) section 6203, are required to register with the State Board of Equalization (Board), collect California use tax from their California customers when they purchase tangible personal property from the retailers for use in California, and then report and pay the use tax to the Board. (Cal. Code Regs., tit. 18, § 1684, subd. (a).) However, if California consumers purchase tangible personal property for use in California from out-of-state retailers that are not registered with the Board to collect California use tax, then the California consumers must report and pay their own use taxes. (Cal. Code Regs., tit. 18, § 1685, subd. (a).)

The Informative Digest included in the Notice of Proposed Regulatory Action explains that:

RTC section 6452.1, as enacted by Statutes 2010, chapter 721, section 2, permits taxpayers to make an irrevocable election to report “qualified use tax” on an “acceptable [income] tax return” filed with the Franchise Tax Board (FTB) in order to make it more convenient for taxpayers to comply with their use tax obligations. RTC section 6452.1, subdivision (d)(2), as enacted by Statutes 2010, chapter 721 defined the term “qualified use tax” to mean a taxpayer’s actual unpaid use tax liability after applying the state use taxes imposed under the Sales and Use Tax Law (RTC § 6001 et seq.) and section 35 of article XIII of the California Constitution, and the local and district use taxes imposed in conformity with the Bradley-Burns Uniform Local Sales and Use Tax Law (RTC § 7200 et seq.) or in accordance with the Transactions and Use Tax Law (RTC § 7251 et seq.) to the taxpayer’s purchases of tangible personal property subject to use tax.

The Informative Digest included in the Notice of Proposed Regulatory Action further explains that:

SB 86 was enacted on March 23, 2011. It amended RTC section 6452.1 to make it more convenient for taxpayers to comply with their use tax obligations by giving taxpayers the option to report their “estimated use tax liabilities,” based upon their adjusted gross income for income tax purposes, for one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand dollars (\$1000), as determined from a use tax table, instead of calculating and reporting their actual unpaid use tax liabilities (as described above). In addition, RTC section 6452.1, subdivision

(d)(2)(A)(i)(II), as amended by SB 86, provides that “the Board shall annually calculate the estimated amount of use tax due according to a person's adjusted gross income and by July 30 of each calendar year make available to [the] Franchise Tax Board such amounts in the form of a use tax table” for inclusion in the instructions to the FTB’s returns and use by eligible taxpayers.

The Informative Digest included in the Notice of Proposed Regulatory Action also explains that:

- On April 26, 2011, the Board proposed to adopt California Code of Regulations, title 18, section (Regulation) 1685.5, *Calculation of Estimated Use Tax - Use Tax Table*, “to prescribe the use tax table that taxpayers may use to estimate their calendar-year 2011 use taxes based upon their adjusted gross income, prescribe the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person’s adjusted gross income for calendar-year 2012 and subsequent years, and prescribe the format of the use tax tables the Board must make available to the FTB each year”;
- “The objectives of the proposed regulation are to fulfill the Board’s duty to estimate the amount of use tax due according to a person’s adjusted gross income and make the estimate available to the FTB in the form of a use tax table for calendar-year 2011 and to clearly prescribe the manner in which the Board shall estimate the amount of use tax due according to a person’s adjusted gross income and make the estimate available to the FTB in the form of a use tax table for calendar-year 2012 and subsequent years”; and
- “There are no comparable federal regulations or statutes to Regulation 1685.5.”

There have not been any changes to the applicable laws or the general effect of the adoption of proposed Regulation 1685.5 described in the Informative Digest included in the Notice of Proposed Regulatory Action. The following events occurred after the issuance of the Notice of Proposed Regulatory Action.

On June 13, 2011, the Board received written comments and questions regarding the adoption of proposed Regulation 1685.5 from Gene Johnson.

On June 14, 2011, language was added to the text of Assembly Bill No. 28X (2011-2012 1st. Ex. Sess.) (ABx1 28) to amend the definition of a “retailer engaged in business in this state” in RTC section 6203. The amendments to RTC section 6203 were intended to increase the number of out-of-state retailers that are “engaged in business in this state” and therefore required to register with the Board, collect California use tax from their California customers, and remit the use tax to the Board.

On June 20, 2011, the Board received written comments from Gina Rodriguez, Vice President of Tax Policy for the California Taxpayers Association (CalTax), regarding the adoption of proposed Regulation 1685.5.

On June 21, 2011, the Board held a public hearing regarding the adoption of proposed Regulation 1685.5. Prior to the hearing, Senator George Runner (Ret.), Board Member for Board of Equalization District 2, asked Board staff to prepare an alternative use tax table for the 2011 use tax table proposed to be prescribed by subdivision (d)(1) of Regulation 1685.5. He also requested that the alternative use tax table be based upon the assumptions that: (1) Governor Brown would sign ABx1 28; and (2) the Board would collect, during the remaining portion of 2011, all of the approximately \$317 million of additional state, local, and district use tax (approximately \$200 million General Fund) the Legislature estimated that the Board would collect during the 2011-2012 fiscal year (July 1, 2011, to June 30, 2012) due to the enactment of ABx1 28. Therefore, Board staff prepared the alternative use tax table and distributed it to the Board Members as part of a June 20, 2011, memorandum from Robert Ingenito, Chief of the Board's Research and Statistics Section, for consideration at the June 21, 2011, public hearing.

During the June 21, 2011, public hearing, the Board considered whether to:

- Adopt the original text of proposed Regulation 1685.5 without any changes;
- Make changes to the original text of the proposed regulation to substitute Senator Runner's alternative use tax table for the use tax table originally proposed to be included in Regulation 1685.5, subdivision (d)(1); or
- Make changes to the original text of the proposed regulation so that the regulation includes Senator Runner's alternative use tax table and the use tax table originally proposed to be included in Regulation 1685.5, subdivision (d)(1), and provides that the former will be effective if ABx1 28 is enacted and the latter is effective if ABx1 28 is not enacted.

However, on June 21, 2011, the Board could not be certain that Governor Brown would sign ABx1 28 or that the Board would realize the use tax revenue estimated to be collected as a result of its signing. Therefore, the Board voted to continue the public hearing during its July 26-27, 2011, meeting. (No interested parties made oral comments to the Board during the June 21, 2011, public hearing.)

Governor Brown signed ABx1 28 on June 28, 2011, and the bill amended RTC section 6203 as explained above. However, the Board did not see an immediate increase in the number of out-of-state retailers registered with the Board to collect California use tax subsequent to the enactment of ABx1 28. Furthermore, on July 18, 2011, Attorney General Kamala D. Harris delivered the circulating title and summary to the Secretary of State for a proposed statewide referendum on ABx1 28.

On July 26, 2011, the Board continued the public hearing regarding the adoption of proposed Regulation 1685.5. Gina Rodriguez appeared at the public hearing on behalf of CalTax and commented that, in CalTax's opinion, the 2011 use tax table proposed to be prescribed by Regulation 1685.5, subdivision (d)(1), over estimates consumers' use tax liabilities based upon their adjusted gross income and urged the Board to work with CalTax and other interested parties to further refine the calculations for the 2012 use tax table. (Gina Rodriguez's oral comments are more fully summarized and responded to

below). Also, during the public hearing, Board staff explained the need for the Board to adopt proposed Regulation 1685.5 so that: (1) the Board could forward the 2011 use tax table prescribed by Regulation 1685.5, subdivision (d)(1), to the FTB by the July 30, 2011, deadline specified in RTC section 6452.1; and (2) there would be some chance that the regulation would be reviewed and approved by the Office of Administrative Law (OAL) prior to the FTB's September 1 deadline to transmit the instructions for its 2011 income tax returns to its publisher and the software developers. The September 1 deadline ensures that the printed 2011 instructions and 2011 return preparation software is available at the end of 2011 when taxpayers can begin preparing their 2011 income tax returns.

At the conclusion of the continued July 26, 2011, public hearing, the Board voted to adopt Regulation 1685.5, as originally proposed, because the Board determined that its adoption is necessary to prescribe:

- The use tax table that taxpayers may use to estimate their calendar-year 2011 use taxes based upon their adjusted gross incomes;
- The manner in which the Board shall annually calculate the estimated amount of use tax due according to a person's adjusted gross income for calendar-year 2012 and subsequent years; and
- The format of the use tax tables the Board must make available to the FTB by July 30 each year.

The Board considered Gene Johnson's and Gina Rodriguez's comments prior to the adoption of proposed Regulation 1685.5 and their comments are summarized and responded to below and in the Final Statement of Reasons.

Public Comments and Questions

In her June 20, 2011, letter, Gina Rodriguez expressed CalTax's recommendation that the Board reject proposed Regulation 1685.5. In her letter, Gina Rodriguez questioned whether the Board needed to adopt a regulation to implement, interpret, and make specific the use tax table provisions of RTC section 6452.1 and whether the Board needed to include the 2011 use tax table in the regulation. She expressed concern that the Board's rulemaking timeline did not give CalTax adequate time to vet its concerns, and she expressed CalTax's opinion that the 2011 use tax table prescribed by proposed Regulation 1685.5, subdivision (d)(1), overstates a taxpayer's use tax liability. She also said that the 2011 use tax table prescribed by the proposed regulation is inaccurate because it estimates that a person with \$1 of adjusted gross income may have a \$7 use tax liability.

In addition, Gina Rodriguez attached an April 25, 2011, letter from Robert Gutierrez, Research Analyst for CalTax, to Board Chairman Jerome Horton to her June 20, 2011, letter. In the April 25, 2011, letter, Robert Gutierrez expressed his desire that the Board conduct interested parties meetings to further discuss the methodology used to develop proposed Regulation 1685.5. He stated that he thought the Board should use different

percentages to estimate the use tax liabilities for consumers in different income ranges, and he thought the Board should do more to take differing local use tax rates into account when estimating use tax liabilities. He also stated that he thought the statewide use tax rate may decline on July 1, 2011, and that he thinks the 2011 use tax table prescribed by Regulation 1685.5 does not take this rate change into account.

During the continued July 26, 2011, public hearing, Gina Rodriguez stated that CalTax now understands why the Board needs to adopt a regulation to implement, interpret, and make specific the use tax table provisions of RTC section 6452.1, but that CalTax still questions the need to prescribe the specific 2011 use tax table in a regulation. She expressed CalTax's opinions that the 2011 use tax table prescribed by Regulation 1685.5, subdivision (d)(1), should take into account the effect of ABx1 28, that Regulation 1685.5 should estimate that lower income consumers owe a higher amount of use tax as a percentage of their adjusted gross income than higher income consumers because the sales and use tax is essentially a regressive tax, that the Board's use tax tables should have more adjusted gross income ranges, and that the Board's use tax tables should somehow allow consumers to use varying district use tax rates to determine their estimated use tax liabilities. She expressed some concern that the Board might impose a double tax if a taxpayer reports its estimated use tax using the Board's look-up table. She also asked how the Board would allocate reported estimated use tax among state, local, and district use taxes.

Gene Johnson's June 13, 2011, email asked why the Board's Initial Statement of Reasons says that the Board has determined that the adoption of proposed Regulation 1685.5 "will not have a significant adverse economic impact on business," but also states that the adoption of the proposed regulation "may affect small business." The email suggests that the Board simply adopt an estimated use tax percentage that consumers can multiply by their adjusted gross income to estimate their use tax liabilities, rather than a use tax table, and that the Board adopt a de minimis exemption from use tax for consumers with small use tax liabilities. The email asks whether the proposed regulation should specify who may or may not use the Board's use tax tables to estimate their use tax liabilities. The email also asks whether the Board is precluded from assessing additional use tax when a consumer reports his or her estimated use tax liability and that amount is less than the consumer's actual use tax liability.

Furthermore, the Board received inquiries from members of the general public, such as Candy Messer and Katherine Craig, via email and telephone, as to whether the Board was seeking to impose a new tax on Californians by adopting proposed Regulation 1685.5.

Responses to Public Comments and Questions

First, the Board does not have the authority to impose new taxes via a regulation and the adoption of proposed Regulation 1685.5 will not impose any new taxes, as explained in the Initial Statement of Reasons. The Board is adopting proposed Regulation 1685.5 to prescribe the use tax table that eligible consumers may, but are not required, to use to estimate their calendar-year 2011 use taxes based upon their adjusted gross incomes,

prescribe the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person's adjusted gross income for calendar-year 2012 and subsequent years, and prescribe the format of the use tax tables the Board must make available to the FTB each year, as explained above and in the Notice of Proposed Regulatory Action.

Second, the Board did not have adequate time to conduct interested parties meetings before initiating the formal rulemaking process to adopt proposed Regulation 1685.5 because:

- The use tax table provisions were added to RTC section 6452.1 on March 23, 2011;
- The Board needed to adopt a 2011 use tax table and forward it to the FTB for inclusion in the instructions to the FTB's 2011 income tax returns by the July 30, 2011, deadline specified in RTC section 6452.1; and
- The FTB needs to know that the 2011 use tax table adopted by the Board has been approved by OAL by September 1 and will be effective for use with 2011 income tax returns so that the FTB can include the 2011 use tax table in the instructions to its 2011 income tax returns, which will be sent out for publication and incorporation into return preparation software on September 1, 2011.

However, the Board has already scheduled interested parties meetings to discuss whether the Board needs to amend Regulation 1685.5 before the July 30, 2012, deadline, in which it is required to estimate consumers' 2012 use tax liabilities based upon their adjusted gross incomes and prepare a 2012 use tax table for transmission to the FTB.

Third, the Board does not believe that the 2011 use tax table overestimates consumers' use tax liabilities based upon their adjusted gross incomes. Proposed Regulation 1685.5 prescribes a reasonable methodology for estimating consumers' use tax liabilities based upon their adjusted gross income ranges using a "use tax liability factor" determined by:

1. Multiplying the percentage of income spent on electronic and mail order purchases for the preceding calendar year, as determined by the United States Census Bureau, by 0.37, which represents the estimated percentage of California consumers' total purchases of tangible personal property for use in California that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers; and
2. Multiplying the product by the average state, local, and district sales and use tax rate, and then rounding the result to the nearest thousandth of a percent.

The Board believes that this methodology provides a reasonably accurate estimate of California consumers' use tax liabilities based upon the assumptions that California consumers spend an average percentage of their incomes on electronic and mail order purchases and that they also make an average percentage of their total purchases of tangible personal property for use in California from unregistered out-of-state retailers. The Board recognizes that a particular consumer's actual use tax liability may be higher

or lower than the consumer's estimated use tax liability as determined using the methodology in the proposed regulation, however, that would be the case with any reasonable estimate.

Fourth, the 2011 use tax table prescribed by subdivision (d)(1) of proposed Regulation 1685.5 uses a "use tax liability factor" that was generally computed in accordance with the methodology prescribed in subdivision (b) of the regulation. However, the Board was aware that the statewide sales and use tax rate would decrease by 1 percent effective July 1, 2011. As such, the Board used the average of the statewide sales and use tax rates effective before and after July 1, 2011, as the rate of the statewide sales and use taxes imposed under section 35 of article XIII of the California Constitution and the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.), for the purpose of calculating the use tax liability factor for the 2011 use tax table, which will apply to use taxes incurred between January 1, 2011, and December 31, 2011. Therefore, the 2011 use tax table prescribed by proposed Regulation 1685.5 does take the July 1, 2011, rate change into account. And, it was necessary for the Board to incorporate the entire 2011 use tax table into the proposed regulation in order for that table to employ an average statewide use tax rate for calendar year 2011.

Fifth, the Board understands that the rate of district taxes varies throughout the state. However, the Board's estimated use tax table is intended to make it more convenient for consumers to report their use taxes by allowing them to report estimated amounts determined by reference to their adjusted gross income ranges. It also eliminates the need for consumers to calculate their actual use tax liabilities by determining the total "sales price" of all the tangible personal property they purchased from unregistered out-of-state retailers for use in California, determining their cumulative state, local, and district use tax rates, and then multiplying their total sales prices by their cumulative use tax rates. Therefore, the Board decided to create one statewide use tax table for each year and to simplify its use tax table by incorporating a weighted average rate of district taxes into the "use tax liability factor" prescribed by proposed Regulation 1685.5. Otherwise, the Board would be required to adopt a separate use tax table for each cumulative state, local, and district use tax rate in effect in California. This would cause further inconvenience for consumers by requiring that they look-up their own cumulative use tax rates and estimate their use taxes using the use tax table that corresponds with their cumulative use tax rates. Reported estimated use tax will first be allocated to local and district taxes and the remainder will be allocated to state use tax. Local use taxes are imposed in accordance with the uniform rates specified in RTC sections 7203 and 7203.1.

Sixth, the Board notes that a person with no adjusted gross income can incur a \$7 use tax liability if the person makes sufficient purchases of tangible personal property for use in California from unregistered out-of-state retailers using income that is excluded from the calculation of the person's adjusted gross income, the person's savings, borrowed funds, and/or money received as a gift. For example, if a consumer with no adjusted gross income receives a \$100 cash gift, that person could incur an actual \$7.75 use tax liability by making a single \$100 purchase of tangible personal property for use in California from

an unregistered out-of-state retailer, assuming a 7.75 percent cumulative state, local, and district use tax rate applies and that the use of the property is not exempt from use tax.

Seventh, ABx1 28 was not signed into law until the middle of 2011 and the Board has not documented any noticeable increase in the number of out-of-state retailers registered with the Board to collect California use tax since the enactment of ABx1 28. Therefore, the Board does not believe that proposed Regulation 1685.5 needs to be amended to take into account the revenue the Legislature estimated that the Board would collect due to the enactment of ABx1 28. However, the Board will continue to monitor the effect of ABx1 28 and may consider amending Regulation 1685.5 if it does have a relevant effect on the behavior of out-of-state retailers.

Eighth, the Board did not have enough time and data to determine whether the Board's use tax tables should estimate that lower income consumers owe a higher amount of use tax as a percentage of their adjusted gross income than higher income consumers or whether the Board needs to add more adjusted gross income ranges to its use tax tables. Therefore, Board staff has already committed to specifically discussing whether the Board's use tax tables should estimate that lower income consumers owe a higher amount of use tax as a percentage of their adjusted gross income than higher income consumers and whether the Board needs to add more adjusted gross income ranges to its use tax tables during the upcoming interested parties meetings to discuss whether the Board needs to amend Regulation 1685.5 for the July 30, 2012, deadline.

Ninth, the Board understands that there is a potential for double taxation when California consumers purchase tangible personal property for use in California from unregistered out-of-state retailers that the Board determines are engaged in business in this state. For example, assume that California consumer A purchases tangible personal property for use in California from unregistered out-of-state retailer B and then California consumer A reports and pays A's own use tax liability. However, the Board subsequently determines that unregistered out-of-state retailer B is engaged in business in California. Therefore, unregistered out-of-state retailer B was required to register with the Board, collect applicable use tax from its California customers, including California consumer A, and remit the use tax to the Board, and unregistered out-of-state retailer B is personally liable for California use taxes that B failed to collect pursuant to the Board's regulations. (Cal. Code Regs., tit. 18, § 1684, subds. (a) and (e).) In such a case, it is potentially possible that the Board could bill unregistered out-of-state retailer B for the use tax it failed to collect from California consumer A, but which California consumer A already reported and paid. However, the Board will not bill an unregistered out-of-state retailer, such as B in the above example, when the Board knows that the use tax has already been reported and paid by a consumer, such as California consumer A in the above example. The fact that a consumer may report his or her estimated use tax liability to the Board, instead of reporting the consumer's actual use tax liability, does not increase the likelihood of double taxation.

Tenth, RTC section 6452.1 requires the Board to transmit a look up table to the FTB that consumers can use to estimate their use tax liabilities based upon their adjusted gross

incomes. The Board does not see how this statutory requirement can be satisfied by simply adopting an estimated use tax percentage that consumers can multiply by their adjusted gross incomes to estimate their use tax liabilities, rather than a use tax table. Further, it is more convenient for consumers to use a use tax table that prescribes the estimated use tax liabilities for consumers in most adjusted gross income ranges, rather than a table that requires all consumers to make additional calculations to estimate their use tax liabilities.

Eleventh, the Sales and Use Tax Law does not provide a de minimis exemption from sales and use tax. Therefore, the Board does not believe that it has authority to adopt such an exemption through a regulation.

Twelfth, RTC section 6452.1 specifies the types of consumers who may use the Board's use tax tables to estimate their use tax liabilities. Therefore, proposed Regulation 1685.5 does not need to incorporate the same information.

Thirteenth, eligible consumers may report their use tax liabilities on their income tax returns, but they are not required to report their use taxes on their income tax returns and they always have the option to report and pay their actual use tax liabilities directly to the Board. Furthermore, eligible consumers that choose to report their use taxes on their income tax returns are not required to use the Board's use tax tables to estimate their use tax liabilities and then report their estimated use taxes on their income tax returns; they still have the option to calculate their actual use tax liabilities and report their actual use taxes on their income tax returns. However, if an eligible consumer elects to satisfy his or her use tax reporting obligation by reporting his or her estimated use tax liability based upon the consumer's adjusted gross income, for one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand dollars (\$1000), as determined from a use tax table prescribe by the Board, instead of calculating and reporting the consumer's actual unpaid use tax liability, then the Board is precluded from assessing additional tax on such nonbusiness purchases per RTC section 6452.1, subdivision (g).

Fourteenth, OAL staff has requested that all of the Board's Initial Statements of Reasons state that "the proposed regulation may affect small business." Board staff is not aware of any legal authority requiring the statement, but the Board includes the statement as a courtesy to OAL staff. The statement does not indicate that the Board believes that the proposed regulation "will" actually affect small business or have a significant adverse economic impact on business.